IN THE

Supreme Court of the United States

October Term, 1952

No. 160

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC.,

Petitioners,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and DELTA FINANCE CO., LTD.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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TABLE OF CONTENTS

	PAGE
Opinions Below	1
Jurisdiction	2
Statutes Involved	2
Statement	2
1. Plaintiff's $75,000,000 stock loss	2
2. The use of plaintiff's loss as a tax credit to wipe out respondent's tax liability	3
3. The anomaly of respondent's retaining all, and plaintiff's none, of the $17,000,000 tax benefit	5
4. The divided allegiance of the plaintiff's management; respondent's domination and control of plaintiff	6
5. The proceedings below	9
Questions Presented	11
Reasons for Granting the Writ	12
Point I—The construction of the Federal Tax Laws by the majority below is contrary to uniform and overwhelming authority	13
A	13
B	19
C	19
Point II—The Court below improperly found—without support in the District Court's decision—that respondent's retention of the savings conformed with the "past practice" of the parties and "the policies and directions" of the plaintiff. These improper findings were essential for the decision below	20

PAGE

A—The findings of "past practice" by the Court below 21

B—The findings of the Court below that the tax transactions were handled in conformance with "the policy and directions" of plaintiff 23

POINT III—The Court below's conclusions of law concerning the fiduciary relations and duties between the parties are not based on the application of any local law and are clearly contrary thereto 27

A—The majority's conclusion of law that plaintiff was respondent's fiduciary is erroneous 27

B—The majority's holding that respondent was not plaintiff's fiduciary is erroneous 28

C—The Court below erred in holding that the fiduciary duty of fairness permits the fiduciary to use the *cestui* for its own profit so long as the *cestui* is not damaged thereby 31

CONCLUSION 33

APPENDIX: Text of Statutes and Regulations Relied On 1

Internal Revenue Code 1
§ 23(g) 1
§ 141 2
§ 52 4

Treasury Regulation 104 4
§ 23.12 4
§ 23.15 5
§ 23.16 6

Title 28 U. S. C., § 46(c) 7

R. C. P., Rule 52(a) 7

TABLE OF CASES

PAGE

Alameda Investment Co. v. McLaughlin, 28 F. 2d 81 (D. C., N. D. Cal., 1928), aff'd 33 F. 2d 120 (C. C. A. 9, 1929) ... 14

Allied Chemical & Dye Corporation v. Steel and Tube Co., 14 Del. Chan. 1, 120 Atl. 486 ... 27

Atlantic City Electric Co. v. Commissioner, 288 U. S. 152 (1933) ... 14

Banco Kentucky Co.'s Receiver v. National Bank of Kentucky's Receiver, 281 Ky. 784, 137 S. W. 2d 357 (1939) ... 31

Blaustein v. Pan American P. & T. Co., 263 App. Div. 97, 31 N. Y. S. 2d 934 (1st Dept., 1941), aff'd 293 N. Y. 281, 56 N. E. 2d 705 (1944) ... 27

Blum v. Fleishhacker, 21 F. Supp. 527, (D. C., N. D. Cal., 1937), mod. and aff'd 109 F. 2d 543, cert. den. 311 U. S. 665 ... 30

Burnet v. Aluminum Goods Mfg. Co., 287 U. S. 544 (1932) ... 18

Chelrob v. Barrett, 293 N. Y. 442, 57 N. E. 2d 825 (1944) ... 29

Cities Service Co., Matter of, S. E. C. Holding Co. Act., Release No. 5535, January 3, 1945, file No. 70-988 ... 19

Consolidated Electric & Gas Co., Matter of, 15 S. E. C. 161 (1943) ... 18, 19

Consolidated Rock Products Co. v. DuBois, 312 U. S. 510 (1941) ... 28

Duke Power Co. v. Commissioner, 44 F. 2d 543 (C. C. A. 4, 1930), cert. den. 283 U. S. 903 ... 14, 15, 16

Ecker v. Western Pac. R. Corp., 318 U. S. 448 (1943) ... 3

Geddes v. Anaconda Copper Mining Co., 245 Fed. 225 (C. C. A. 9, 1917), rev'd on other grounds, 254 U. S. 590 (1921) ... 29, 30

PAGE

George A. Fuller Co. v. Commissioner, 92 F. 2d 72 (C. C. A. 2, 1937) 17, 18

Globe Woolen Co. v. Utica G. & E. Co., 224 N. Y. 483, 121 N. E. 378 (1918) 29

Goodell v. Verdugo Canon Water Co., 138 Cal. 308, 71 Pac. 354 (1903) 29, 30

Handy & Harman v. Burnet, 284 U. S. 136 (1931) 14

Islands Gas & Electric Co., 13 S. E. S. 649 (1943) 19

James Estate, In re. 86 N. Y. Supp. 2d 78 (Surr. Ct., 1948) 31

Keenan v. Eshleman, 23 Del. Ch. 234, 2 Atl. 2d 904 (S. Ct., 1938) 29

Kennedy v. Emerald Coal & Coke Co., 42 Atl. 2d 398 (S. Ct., Del., 1944) 29

Mayflower Hotel Stockholders Protective Committee v. Mayflower Hotel Corp., 173 F. 2d 416 (App. D. C., 1949) 29

Oil Shares Inc. v. Commercial Trust Co. of N. J., 304 U. S. 551 (1937) 13

Phillips-Jones Corporation v. Parmley, 302 U. S. 233, on writ of certiorari, reversing 88 F. 2d 958 (C. C. A. 3, 1937) 12

Potter v. Sanitary Co. of America, 22 Del. Ch. 110, 194 Atl. 87 (1937) 30, 31

San Diego v. San Diego & L. A. R. Co., 44 Cal. 106 (1872) 29

Southern Pacific Co. v. Bogert, 250 U. S. 483 (1919) 27, 28

Spreckles v. Commissioner, 41 B. T. A. 370 (1940) 14

Title Ins. & Tr. Co. v. California Development Co., 171 Cal. 173, 152 Pac. 542 (1915) 29

Trinity Buildings Corp. v. Commissioner, 40 B. T. A. 1315 (1939) 18

TABLE OF STATUTES AND REGULATIONS

	PAGE
Internal Revenue Code:	
§ 23(g)2	2
	App. 1
§ 23(g)4	2, 3
	App. 1
§ 52	2
	App. 4
§ 122(b)	4
§ 141	2, 3
	App. 2
R. C. P. 52(a)	2
	App. 7
Securities and Exchange Commission, Rule U-45(b)(6)	19
Supreme Court Rule 38(5)(b)	11, 12
Treasury Regulation 104	2
§ 23.12	4
	App. 4
§ 23.15(a) and (d)	18
	App. 5
§ 23.16	4
	App. 6
28 U. S. C. § 46(c)	2, 12
28 U. S. C. § 1254(1)	2
28 U. S. C. §§ 1291 and 1294(1)	2
28 U. S. C. §§ 1331 and 1332	2

TABLE OF AUTHORITIES

Fletcher, Corporations, Vol. 13, § 5811, pages 127-8	28
48 Harv. L. Rev. 1, 8, per Mr. Justice Harlan F. Stone	6
65 Harv. L. Rev. 1256, May 1952	12
Report of the Senate Finance Committee, 70th Cong., 1st Sess., S. R. 960, p. 14 (1928)	14

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC., plaintiffs-intervenors below, pray that a writ of certiorari issue to review (a) the judgment of the United States Court of Appeals for the Ninth Circuit, entered on October 29, 1951, and (b) that Court's order of January 30, 1952 denying their petition for rehearing and striking their petition for rehearing *en banc.* Said petitioners are preferred stockholders of the plaintiff and submit this petition simultaneously with plaintiff's petition.

Opinions Below

The opinion of the District Court (R. 258) is reported in 85 F. Supp. 868. The opinion of the Court of Appeals

(R. 2214) affirming the judgment of the District Court and the dissenting opinion of Fee, J. (R. 2239) have not yet been reported. A further opinion of the Court of Appeals striking petitions for rehearing *en banc* (R. 2260) and the opinion of Fee, J. dissenting therefrom and suggesting a rehearing by all the Court of Appeals Judges (R. 2261) have not yet been reported.

Jurisdiction

The Court of Appeals judgment was entered October 29, 1951 (R. 2255). Thereafter on January 30, 1952 a petition for rehearing *en banc,* or alternatively for rehearing duly filed was denied, the prayer for rehearing *en banc* being ordered stricken as "without authority in law or in the rules or practice" of the Court (R. 2260). By order dated April 24, 1952, this Court extended petitioners' time for seeking certiorari until June 27, 1952.

The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1). The Court of Appeals had jurisdiction under 28 U. S. C. §§ 1291 and 1294(1), and the District Court had jurisdiction under 28 U. S. C. §§ 1331 and 1332.

Statutes Involved

The statutes relied upon are Internal Revenue Code §§ 23(g)(2) and (4), 52 and § 141; Treasury Regulation 104, Title 28 U. S. C. § 46(c), R. C. P. 52(a); the pertinent provisions thereof are reprinted in the appendix hereto.

Statement

1. *Plaintiff's $75,000,000 stock loss.* In 1916, plaintiff, a holding company, acquired for $75,000,000 all the stock of respondent, an operating railroad company (R. 493). In 1935, respondent went into reorganization (Bank-

ruptcy Act, § 77) and remained in reorganization under two court appointed Trustees until December 29, 1944 (R. 494, 1908, 1916).

On March 15, 1943 this Court reinstated the Interstate Commerce Commission's plan, which declared that plaintiff's stock interest in respondent was without equity and not entitled to share in the assets of the reorganized respondent. *Ecker* v. *Western Pac. R. Corp.*, 318 U. S. 448 (1943).

This plan was consummated on December 29, 1944, when the reorganization Trustees returned the assets to respondent and respondent issued its new securities in accordance with the plan (R. 499, 2000).

Respondent's reorganization irretrievably wiped out plaintiff's $75,000,000 investment in respondent's stock. After March 15, 1943—the date of the Supreme Court's affirmance of the reorganization plan—plaintiff and respondent became and remained economic strangers to each other. However prosperous respondent might become in the future, plaintiff had no share therein.

2. *The use of plaintiff's loss as a tax credit to wipe out respondent's tax liability.* Staggering as plaintiff's loss was, it presented one mitigating feature: The tax laws gave plaintiff the right to deduct this loss for income and excess profits tax purposes. (Internal Revenue Code, § 23(g)(4)). This section, enacted in 1942, provided that losses resulting from the worthlessness of a stock investment in an affiliate were to be treated as operating losses (rather than as capital losses as theretofore).

Plaintiff's loss was so utilized, but it derived no benefit therefrom whatsoever. Instead, the entire benefit was reaped by respondent—plaintiff's loss was used to discharge respondent's tax liabilities. This was accomplished through the mechanics of consolidated tax returns.

Under the Internal Revenue Code, § 141 consolidated tax returns may be filed for a group of corporations headed by

a common parent and interconnected by at least 95% stock ownership. In such a return, the respective losses and profits of each of the affiliated corporations are offset against each other and taxes are paid on any net profit for the group as a whole. However, only the parent can file such a return (Treasury Reg. 104, §§ 23.12 and 23.16).

Although this Court's decision rendered plaintiff's stock interest in respondent worthless, plaintiff, nonetheless, continued to be the legal owner of all of respondent's stock. This was so because respondent's reorganization was not consummated until much later. Plaintiff's ownership of this old stock continued until April 30, 1944, on which date plaintiff surrendered all of this stock to respondent's reorganization committee (R. 260). Hence the plaintiff, for tax purposes, continued as respondent's parent and had the right to file consolidated returns for the year 1943 and the first four months of 1944.*

Since respondent, during this period, had earned substantial profits from its wartime railroad operations, it would have had to pay a huge tax thereon, more than $17,000,000 (R. 262). But there was an alternative to the payment of this tax: To cause plaintiff to file consolidated tax returns and for plaintiff therein to offset its huge stock loss against respondent's profits, resulting in no tax payable by respondent. This could be accomplished not only for the year 1943, in which plaintiff's stock loss had occurred, but also by carrying this loss back and forward to 1942 and 1944, respectively (Internal Revenue Code, § 122(b)).

Exactly this was done. As a result, plaintiff's stock loss wiped out respondent's tax liability for the year 1943 and 1944 and provided the basis for a refund of the taxes paid for the year 1942.

Thereafter, in August, 1947, by settlement with the Commissioner of Internal Revenue, the returns for 1943 and 1944 were approved as filed and the claim for refund was denied (R. 171-5, 262-3).

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* Hereafter referred to as the year 1944.

Thus respondent, instead of paying more than $21,000,000 in taxes for the period 1942-44; paid only about $4,000,000. Respondent therefore saved $17,000,000 by using plaintiff's tax credit (R. 266-7).

3. *The anomaly of respondent's retaining all, and plaintiff's none, of the $17,000,000 tax benefit.* Normally one suffering a loss, deductible for tax purposes, will likewise be the beneficiary of the tax savings flowing from this deduction. To state that the tax laws intend this result merely emphasizes the obvious.

Nor would this purpose be any less effectuated in consolidated returns. There a parent corporation would deduct its loss from the earnings of a subsidiary. The resulting tax savings of the subsidiary normally would automatically—through the payment of dividends or through the increased value of the parent's equity in the subsidiary—redound to the benefit of the parent which, in an economic sense, owns the subsidiary's assets.

This result would likewise accord with the purpose of consolidated returns. As will be shown hereinafter (pp. 13-19), such returns were permitted in order to give the owners of a parent corporation utilizing subsidiaries, the same tax benefits as the owners of a corporation doing business through various departments.

But this automatic effectuation of the purposes of the tax laws was impossible in the instant case. Plaintiff's stockholdings of respondent though, legally valid, were actually worthless pieces of paper during the period for which, and at the very time plaintiff was filing consolidated tax returns. The Supreme Court's decision of March 15, 1943 had severed the economic relationship between plaintiff and respondent and in fact respondent had ceased to be plaintiff's subsidiary. Hence, plaintiff could derive no automatic benefit—either through dividends or increased value of stock—from any tax savings conferred on respondent.

If nonetheless the tax savings were permitted to remain where they fell, namely, with respondent, the purpose of the tax laws would be perverted: Plaintiff's stock loss would be unalleviated by any tax advantage; the owners of plaintiff, as the parent, would be denied the benefits of consolidated returns. The prosperous respondent in turn would obtain a wholly gratuitous deduction for a loss which it never suffered. In short, respondent would obtain an undeserved and unmotivated tax windfall.

However, the parties had at hand the means to make sure that the tax benefits would go where in justice and by the spirit of the tax law they belonged, namely, the plaintiff. Suitable arrangement could have been made at the time of the filing of the consolidated returns concerning the ultimate disposition of the resulting tax savings (see *infra*, pp. 18, 19). Such an arrangement would have assured plaintiff all or a substantial portion of the tax savings in effectuation of the purposes of the tax laws.

No such arrangements were made. Instead the tax savings were permitted to remain where they fell—in respondent's hands. Plaintiff received none, although its tax credit and its filing of consolidated returns produced the savings and the tax laws intended these savings to mitigate plaintiff's loss.

This gratuitous conferring of a $17,000,000 benefit on respondent has a simple explanation: "The failure to observe the fiduciary principle, the precept as old as Holy Writ, that 'a man cannot serve two masters'." 48 Harv. L. Rev. 1, 8, per Mr. Justice Harlan F. Stone.

4. *The divided allegiance of the plaintiff's management; respondent's domination and control of plaintiff.* During the critical period in which the consolidated returns were filed, all of plaintiff's officers were respondent's employees; they received their entire compensation from respondent, none from plaintiff (Pl. Ex. 30, R. 527, 1738). Thus plaintiff's president, Mr. Curry, was respondent's employee as well as vice-president, director and a member of its exec-

utive committee (R. 719, 1724). Despite these titles, Curry's actual position was, and had been since 1927, simply that of chief clerk or office manager, under his "boss", Mr. Schumacher, one of respondent's trustees (R. 639). He considered himself merely a "signing officer" (R. 641,) and he signed whatever documents Schumacher, the trustee, or Elsey, respondent's president, told him to sign (R. 642). From June 1, 1943 until the latter part of 1948, Curry's entire compensation was paid by respondent (R. 1738, 1288, 653, 656).

During this critical period, a majority of plaintiff's board of directors were likewise employees of respondent. They, too, received their compensation solely from respondent, not at all from plaintiff (Pl. Ex. 22, R. 1720; R. 1135-1139).

Plaintiff's general counsel (Messrs. Nicodemus and Campbell, constituting the firm of Pierce & Greer) simultaneously were attorneys for respondent and its trustees (R. 793, 1119-21, 2150). For these services, they received their compensation from respondent's trustees plus additional fees from respondent (R. 534-8, 1730-1, 1738). They received no compensation from plaintiff (R. 1723).

Respondent's tax counsel were Whitman Ransom Coulson & Goetz, Messrs. Polk and Coulson being the partners in charge of these tax activities; they likewise became plaintiff's tax counsel and continued as such throughout the critical period (Pl. Ex. 39-A, 39-E, R. 543-547, 556, 1399, 1438-41). That firm's compensation for its tax work was paid exclusively by respondent (R. 548-557).

Thus, in the handling of the tax transactions, plaintiff was without independent management and independent attorneys; the financial stake of all lay with respondent, not plaintiff.

This divided allegiance manifested itself in the handling of the tax returns. At every stage, it was respondent and its tax counsel who took the initiative in the handling of these tax transactions. Plaintiff's role was confined to the mechanical, unquestioning and uninformed execution of

respondent's decisions. Respondent's tax counsel conceived the plan of utilizing plaintiff's stock loss as a tax deduction in consolidated returns (Pl. Ex. 50, R. 1757, 1760-1). They made their recommendation to do so early in 1944, but only to respondent (R. 1267-8, 1410-11, 1448). They sent an opinion from New York to respondent in California (Pl. Ex. 54, R. 605)—with not even a copy to plaintiff in New York (R. 665). Respondent and tax counsel simply determined to use plaintiff's tax credit to eliminate its own taxes without bothering to ask for plaintiff's permission (R. 1448). Respondent's "full time employees", under the supervision of tax counsel, prepared the tax returns (R. 663). They were then submitted to Curry, respondent's employee and plaintiff's president and "signing officer" for his signature. Thereupon Curry did just that. He signed (R. 664). He did so without benefit of advice of independent counsel, without consultation with his board, indeed without any thought whatsoever (R. 664, 808).

Roughly the same procedure was followed in connection with the 1944 returns and the 1942 refund claim. Again respondent and its tax counsel made the decision and the same "signing officer" signed the returns as plaintiff's president (R. 623, 1018, 1449-50). However, by this time, plaintiff's president had moved to the office of respondent's tax counsel, and was receiving a $3000 annual retainer from respondent via tax counsel with instructions "to put himself at Polk's (tax counsel's) disposal" (R. 1498, 1744).

Finally, in 1947, these tax matters culminated in a settlement with the government. The same pattern was pursued in the handling of this settlement. Respondent's tax counsel procured the signature of plaintiff's president on a power of attorney—again without consulting plaintiff's board and without the board's knowledge or approval (R. 667-8, 1025-6). Thereafter, on February 11, 1947, tax counsel submitted a written offer of settlement to the government in plaintiff's name (R. 1430), but he did so after procuring authorization only from respondent, not from

plaintiff (R. 1282-4, 1429-31). Two months later, on the heels of a conference with respondent, tax counsel finally notified plaintiff of the settlement offer which he had made in its name (R. 668-9, Pl. Ex. 68, R. 1788, 1460-1). The reason for this one-sided representation is baldly admitted by tax counsel: "my responsibility was to them (respondent) and not to the corporation (plaintiff)" (R. 1431).

5. *The proceedings below.* In October 1946, prior to the settlement with the government, plaintiff brought the instant action against respondent for an accounting for the tax benefits flowing from the use of plaintiff's tax credits in the consolidated returns.

Petitioners' motion for intervention herein was granted on April 7, 1947 (R. 122).

Both petitioners and plaintiff sought accounting from respondent for the tax savings. However, petitioners as plaintiff's stockholders, at no time connected with its or respondent's management, urged below that, on the facts herein, respondent was plaintiff's fiduciary, charged with a minimum fiduciary duty of "entire fairness" in conducting these tax transactions. To determine the fairness of respondent's taking all, and plaintiff none, of these tax savings, petitioners, inter alia, looked to the animating purposes of the tax laws which permitted these savings, to determine the extent to which this result effectuated or defeated their purpose. We urged on the basis of controlling authority in this and other Courts, and congressional expressions of purpose and intent, that the purpose and intent of the tax laws was to confer on the plaintiff, which suffered the loss and was the parent, the tax savings flowing therefrom. Hence fairness entitled plaintiff, not respondent, to obtain the tax benefits.

The District Court gave judgment to respondent for reasons having nothing to do with the above contentions—indeed, on a ground not urged by any of the parties and

without benefit of any briefs thereon. As stated by Fee, J. (dissenting opinion below):

> "The major portion of the opinion of the Trial Court is devoted to the proposition that the 'tax escape' was a fraud upon the government, and therefore the proceeds were given to the defendant, an active wrongdoer. This position that there was a fraud is given no support by the tax agents of the government who made the settlement. It was expressly repudiated in open court by every party in this case" (R. 2240).

As a "subsidiary theory", the District Court stated that plaintiff's claim to the tax savings was in some fashion at variance with respondent's plan of reorganization (R. 273).

The Court of Appeals affirmed in an opinion by Byrne, District Judge, Healy, Circuit Judge concurring, with dissenting opinion by Fee, District Judge.

However, both majority and dissent rejected the District Court's grounds for its decision.

Broadly summarized, the basis for the majority opinion, leaving respondent with $17,000,000 of tax benefits, is the holding that plaintiff was under a duty to respondent to file consolidated returns, and use its own loss therein in order to obtain and confer tax savings on respondent. The majority reached this conclusion as a matter of law—federal tax law and fiduciary law—and as a matter of fact, based on findings made by it, not the District Court.

The dissenting opinion recommended reversal and remand to permit adequate findings to be made because: "There are no findings of fact which support the judgment of the Trial Court or the affirmance thereof by a majority of this Court" (R. 2239). In the course of sustaining this position, the dissent takes up the contentions of the majority and clearly indicates complete disagreement with them.

Thereafter, petitioners asked the Court below for rehearing *en banc* before all the Court of Appeals Judges of the Ninth Circuit, or alternatively for reargument. The same panel (Byrne and Fee, District Judges, and Healy, Court

of Appeals Judge) entertained the petition and denied the request for reargument; rehearing *en banc* was stricken as "without authority in law or the rules of practice of this court" (R. 2260). Again, Fee, J. dissented, "suggesting rehearing *en banc*":

> "This cause involves the disposition of over $21,000,000.00. The solution requires application of novel statutory language affecting the fields of bankruptcy and taxes. * * *
>
> "* * * Two District Judges and one Circuit Judge constituted the panel which heard the case. As has been pointed out in this serious and important litigation, three District Judges have, respectively, expressed three widely divergent views, while no member of the Court of Appeals has written a line on the merits.
>
> "I therefore suggest to the Court of Appeals a rehearing en banc of all the Circuit Judges. For this there is precedent in this Circuit" (R. 2261-62).

Questions Presented

1. Must a former parent corporation join in consolidated Federal income and excess profits tax returns with its former subsidiary and use therein the former parent's loss to extinguish the tax liability of its former subsidiary, without any accounting by the former subsidiary to the former parent for the benefit thus obtained? The loss so utilized was the parent's loss of its entire investment in the subsidiary. It was so utilized by the former parent's management and counsel at the direction of the former subsidiary for whom they likewise were officers and counsel.

2. Does not the Court of Appeals exceed its appellate office and so far depart from the accepted and usual course of judicial proceedings as to call for this Court's exercise of its power of supervision (Sup. Ct. Rule 38(5)(b)), where the appeals court finds facts *ab initio* to affirm a judgment which it holds to be non-sustainable on the legal theories applied by the trial court, particularly where the appeals

court's findings are contrary to those which the trial court made and to the evidence?

3. May a litigant petition a Court of Appeals for a rehearing *en banc* under 28 U. S. C. § 46(c) after decision by a three-judge panel; or may two judges of the panel strike out such petition as "being without authority in law or in the rules or practice of this court", thus preventing the petition from being considered by the court of seven judges?

Reasons for Granting the Writ

The errors of the majority below present substantial questions of Federal law and procedure which this Court should review. The importance of these errors is emphasized in the dissenting opinion below; in addition, the majority's decision has recently been criticized as erroneous (65 Harv. Law Rev. 1256, May 1952).

The Court below held that the purpose and intent of the Federal tax laws were to give the former subsidiary, respondent, the benefit of the tax savings, and not the former parent, plaintiff. Based on this construction of the tax laws, it gave judgment for respondent. The Court below thereby misconstrued the purposes of the tax laws. Its error on this critical issue of Federal tax law justifies the granting of certiorari herein. See *Phillips-Jones Corporation* v. *Parmley*, 302 U. S. 233, on writ of certiorari, reversing 88 F. 2d 958 (C. C. A. 3, 1937).

The majority below further premised its judgment on findings of fact made, *de novo*, to sustain a theory of recovery not even remotely encompassed by the District Court's opinion. These findings were contrary to those which the trial court made and to the uncontradicted evidence in the record. This highly prejudicial procedure likewise requires review because it is a departure "from the accepted and usual course of judicial proceedings" by Federal courts of appeal (Sup. Ct. Rule 38(5)(b); see also

Oil Shares Inc. v. *Commercial Trust Co. of N. J.*, 304 U. S. 551 (1937), per curiam, granting certiorari and simultaneously reversing and remanding to the District Court for appropriate findings).

The Court below decided questions of fiduciary law without first determining the applicable local law, without citation or discussion of any local law whatsoever and in fact contrary thereto.

In urging the above reasons for certiorari herein, we are mindful of the need for brevity. To that end, we shall avoid unnecessary repetition of material presented in plaintiff's petition for certiorari, simultaneously filed herein. The Court is respectfully referred to the arguments therein (including all discussion of the third question, supra), as supplementary to and in support of this petition.

We proceed to take up the reasons for granting the writ herein.

POINT I

The construction of the Federal Tax Laws by the majority below is contrary to uniform and overwhelming authority.

The majority below held:

> "There is nothing in the Code or Regulations that compels the conclusion that a tax savings must or should inure to the benefit of the parent company or of the company which has sustained the loss that makes possible the tax savings" (R. 2232).

Instead, it found that the tax laws intended to and did give the benefit of such tax savings to the subsidiary, the respondent.

A

In so holding, the majority flies in the face of overwhelming and uniform authority establishing that consolidated returns were designed and intended for the benefit of the

parent, plaintiff, not the subsidiary, respondent: *Handy & Harman* v. *Burnet*, 284 U. S. 136, 140 (1931); *Report of the Senate Finance Committee*, 70th Cong., 1st Sess., S. R. 960, p. 14 (1928), quoted in *Spreckles Co.* v. *Commissioner*, 41 B. T. A. 370, 375 (1940); *Atlantic City Electric Co.* v. *Commissioner*, 288 U. S. 152, 154 (1933); *Duke Power Co.* v. *Commissioner*, 44 F. 2d 543, 545 (C. C. A. 4, 1930), cert. den. 283 U. S. 903. The same rule was enunciated in the 9th Circuit in *Alameda Investment Co.* v. *McLaughlin*, 28 F. 2d 81, 82 (D. C., N. D. Cal., 1928), aff'd 33 F. 2d 120 (C. C. A. 9, 1929); and by the District Court in this case (R. 269).

This was clearly stated in the *Report of the Senate Finance Committee* (supra), quoted in *Spreckels Co.* v. *Commissioner* (supra):

> "The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. * * * The mere fact that by legal fiction several corporations owned by the same stockholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit. To refuse to recognize this situation and to require for tax purposes the breaking up of a single business into its constituent parts is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, from its investments, and from each and every one of its agencies."

To assure that the consolidated group would "in reality (be) one and the same business", Congress adopted the requirement that the parent own 95% of the stock of its subsidiary. It did so with the clear contemplation and design that such a requirement would assure this economic unity. Thus, the same Committee (*supra*, at p. 14) stated

> "Much of the apprehension about consolidated returns will be removed when it is realized that it is only

when the corporations are really but one corporation that the permission to file consolidated returns is given, and that no ultimate advantage under the tax laws really results. The present law permits the filing of consolidated returns only where one corporation owns at least 95 percent of the stock of the other corporation or if at least 95 per cent of the stock of both corporations is owned by the same interest. The provision embodies the business man's conception of a practical state of facts."

Thus the purpose of consolidated returns was simply to give the common owner of a corporation operating through subsidiaries the same tax benefits as the owner of a corporation operating through various departments. In both cases the intended beneficiary was neither the department nor the subsidiary, but rather the owners of the business, i.e., the parent and its stockholders. Hence, neither the department nor the subsidiary, if it operates profitably, would have any ground in its own person to seek a reduction of its taxes, even though another department or another subsidiary has sustained a loss. But the parent (the common owner) can do so because the profits and losses of each department or subsidiary are the profits and losses of the parent.

Hence the right to offset such losses and profits against each other in consolidated returns is the parent's right created in its interest and for its benefit; any advantage flowing to the subsidiary therefrom is merely incidental and the happenstance by which the parent obtains its intended advantage. *Duke Power Co.* v. *Commissioner* (*supra*).

None of the above authorities were discussed or even mentioned by the majority below. Nonetheless, their conclusion was rejected.

The Court below proceeded to reach a diametrically opposite and contrary result, i.e., the tax laws intended to give the subsidiary (the respondent) all the benefit of consolidated returns and the parent (plaintiff) none. The

majority cites no authority whatsoever for this conclusion. Nor can any be cited. It rests its conclusion on a fragmentary analysis of two provisions of the tax law: the provision giving the subsidiary the right to refuse to join in consolidated returns; and the provision permitting consolidated returns for a period of affiliation less than the taxable year, even though such affiliation had ceased at the time for filing such returns.

Neither of these provisions justifies the Court below's conclusions therefrom. The right of the parent, which alone can file consolidated returns, to refuse to do so is not comparable to the right of the subsidiary to refuse to do so. Giving this right to the parent was in furtherance of the purpose and intent that the parent should be the beneficiary of the benefits. Congress viewed the parent and its stockholders as the owners of one business consisting of a group of affiliates (*supra*, pp. 14, 15). It therefore gave the parent the *sole* right to file consolidated returns for the group on the assumption that as the common owner it would and should determine, in its own self-interest whether or not to file such returns. As stated in *Duke Power Co.* v. *Commissioner* (*supra*);

> "It (Congress) assumed that if there was that degree of affiliation which the law required, there was a dominant control, and it gave to that dominant control the right to make the choice" (p. 545).

Hence, concluded that Court, if the parent were to "decide that its best interests require filing by it of a separate tax return, no provision of the law denies it this privilege" (p. 545).

The subsidiary's right was not given for any such reason. Congress obviously did not view the subsidiary as the owner of the group. Therefore, the subsidiary's right to refuse to join is not, like the parent's, given in recognition of its position as the common owner. In fact, it is no more than a protective veto to cover this possible eventuality: Despite the presence of 95% stock ownership, the sub-

sidiary might still be independent of and not properly an economic unit with the parent; it could then exercise its veto and refuse to join in consolidated returns. This has occurred when the subsidiary's trustee in bankruptcy exercised this veto. *George A. Fuller Co.* v. *Commissioner*, 92 F. 2d 72 (C. C. A. 2, 1937).*

Equally unfounded is the Court's reliance on tax law provisions permitting consolidated returns for a period of affiliation less than the taxable year, though the affiliation had ceased at the time of actual filing of returns. Permitting the filing of such returns has an obvious justification: Consolidated returns, if appropriate for a full tax year, are just as appropriate for any part thereof in which the affiliation existed. But such consolidated returns are no different from others. The fact that such returns could be filed does not prove, as the Court below held, that "any benefits to the subsidiary obviously cannot inure to the parent" (R. 2230). Since only the parent can file consolidated returns, its self-interest will determine whether it should or should not file such returns for a shortened period. If the subsidiary in its self-interest should deem it appropriate, it may prevent the filing by exercising its protective veto of non-consent. In short, the filing or non-filing of such returns and the sharing of the benefits therefrom could well be the subject of negotiation and result in both sharing. On the other hand, the parent, in the very act of terminating the affiliation, can insure itself the benefit of subsequent filing of consolidated returns. Thus, if the parent were selling its 95% stock interest in a subsidiary to a stranger and at the time of sale knew that its loss in a consolidated return would confer a $17,000,000 tax saving on the subsidiary, could it be doubted that this would be reflected in the price of the stock being sold?

* As is urged in plaintiff's petition for certiorari, the decision below in effect nullifies this protective veto. The Court below expressly stated that the trustee in reorganization herein, if it had the loss, would have been under a mandatory duty to join in consolidated returns with plaintiff and contribute its loss thereto (R. 2233).

From this right to file consolidated returns after termination of affiliation, the Court further deduces that the tax laws do not "require 'economic unity'". Nor did the appellants argue, as stated by the Court, that the tax laws did *"require"* economic unity. Instead, appellants argued that the tax laws *contemplated* that there would be economic unity during the period of affiliation; the authorities established this contention; (supra, pp. 14, 15). And the statute *required* 95% stock ownership on the theory that compliance with this requirement would effectuate the contemplated objective of economic unity. Instances have arisen where despite literal compliance with the statutory requirement of 95%, the contemplated economic unity did not in fact exist. Nonetheless, the Courts have held that compliance with the literal statutory requirement is the test for the filing of consolidated returns. *Burnet* v. *Aluminum Goods Mfg. Co.*, 287 U. S. 544 (1932); *George A. Fuller Co.* v. *Commissioner*, 92 F. 2d 72 (C. C. A. 2, 1937); *Trinity Buildings Corp.* v. *Commissioner*, 40 B. T. A. 1315 (1939). It is precisely that compliance with the literal statutory requirement which permitted consolidated returns herein, dispite the absence of economic unity.

But this result hardly establishes, as the Court below found, that therefore consolidated returns are permitted for the benefit of the subsidiaries. The purpose of the tax laws remains unaltered. But in this and similar cases the purpose of the tax laws is not automatically effectuated. The parent's normal and automatic benefiting from its subsidiary's savings, could not occur; it held mere pieces of paper representing neither equity nor right to dividends. Hence, the statutory purpose required effectuation in another fashion, namely, by an agreement among the parties allocating the resulting tax savings.

Agreements of this type are expressly permitted by the tax regulations (Treas. Reg. 104, § 23.15(a) and (d), Appendix herein). Such agreements are a familiar device and have received administration sanction and approval. *Matter of Consolidated Electric & Gas Co.*, 15 S. E. C. 161

(1943); the *Islands Gas & Electric Co.,* 13 S. E. C. 649 (1943); *Matter of Cities Service Co.,* S. E. C. Holding Co. Act, Release No. 5535, January 3, 1945, file No. 70-988.*

B

Finally, not only has the majority below misconstrued the purpose of consolidated returns, but it has also overlooked the purpose of another aspect of the tax laws. Congress in 1942 made a loss in the stock of an affiliate deductible against ordinary income. It did so for an obvious purpose. It wished to mitigate the economic impact of such stock loss by any tax savings resulting from its deductibility. This purpose, too, has been subverted herein. For plaintiff suffered the loss, but only respondent obtained the tax savings resulting therefrom. Patently, plaintiff's loss has not been mitigated when tax savings resulting therefrom go to another, the respondent.

C

For the above reasons we submit that it is indefensible for the majority below to conclude:

"There is nothing in the Code or Regulations that compels the conclusion that a tax saving must or

* In each case, the S.E.C., pursuant to its Rule U 45(b)(6), approved as fair and reasonable agreements allocating tax savings. In each instance, the parent received the benefit of those savings. But the question posed was how it should receive that benefit. In *Matter of Consolidated Electric & Gas Co. (supra)*, the parent was permitted to obtain these savings by direct payment from the subsidiaries in whose pockets the savings originally fell; there, as here, the parent's loss produced the saving—the loss being, as here, in the stock of a subsidiary. In the other two cases, the tax savings were paid to the subsidiary contributing a particular deduction with the parent still benefiting therefrom. Indeed, the need for such an agreement is much stronger in the instant case than in those before the Commission. For in each of those cases the consolidated group was an economic unit and the benefits did automatically inure to the parent; thus permission for tax saving payments there was a matter of expediency, whereas in the instant case, with the economic unity destroyed, such payments were a matter of necessity.

should inure to the benefit of the parent company or of the company which has sustained the loss that makes possible the tax saving" (R. 2232).

Equally indefensible was the Court's unsupported holding that these tax laws did compel the conclusion that the tax savings must and should inure to the subsidiary which didn't suffer any loss.

This erroneous interpretation of the tax laws was then used as an essential link in concluding that respondent, not plaintiff, was entitled to judgment herein. For, said the Court, whether plaintiff be respondent's fiduciary (as it held) or both were under a fiduciary duty to deal with each other without "unfairness" (as it assumed)—performance of these duties entitled respondent to the tax savings because they were "an advantage which the tax laws give the subsidiary" (R. 2234), which "it was entitled to under the tax laws" (R. 2232), and which plaintiff "owed a duty not to require its subsidiary to forego" (R. 2234).

Again, the Court below found performance of these duties in certain conclusions of fact which it drew. We proceed to show that these facts were found, without support in the District Court's decision and contrary to the evidence in the record.

POINT II

The Court below improperly found—without support in the District Court's decision—that respondent's retention of the savings conformed with the "past practice" of the parties and "the policies and directions" of the plaintiff. These improper findings were essential for the decision below.

The majority below found as a fact that the group, since 1946, had filed consolidated tax returns and no member made any payment over to any other member of the group contributing a loss and producing tax savings therefrom.

It found that the parties, in joining in consolidated returns for the critical period herein, without plaintiff's obtaining any of the tax savings flowing from the inclusion of its loss, acted in conformance with their "past practice". Furthermore, found the Court below, filing and joining in consolidated returns in this fashion, conformed with "the policy and directions" of plaintiff.

Hence, based on these findings, the Court held that plaintiff was not entitled to recover any of the tax savings herein since defendant's retention was in conformance with the alleged "past practice" of the parties and its own "policies and directions".

Implicitly recognizing the need for findings of the trial court to justify these essential findings of fact, the majority stated:

> "In the instant case the trial court's opinion discloses adequately the issues of fact which were before the court and the court's findings thereon" (R. 2236).

As we shall see, the trial court's opinion, performs no such function with respect to "past practice"; with respect to the corporation's "policy and directions", its findings are contrary to those of the majority below.

A

The findings of "past practice" by the Court below.

The trial court made no findings whatsoever on this alleged practice; its opinion is silent on this issue. Past practice was totally immaterial for its decision. Therefore, both petitioners and the appellate court were deprived of the judgment of the trier of the facts on this issue. The majority below was therefore compelled to make its own findings *de novo*.

The vice of permitting such *de novo* findings is not merely technical. Frequently trial courts, during the trial, give strong indications that certain issues are immaterial; counsel therefore abjures rebuttal evidence; and the trial

court adheres to this view in its decision. If the appellate court overrules this view and, instead of remanding, then proceeds to make its own findings of fact on such a record, the litigant and his counsel have been neatly trapped. In the instant case, the trial court did express the view that past practice and evidence thereon was immaterial.* No rebuttal evidence was adduced. The trial court in its opinion adhered to his view. Nonetheless, the majority, adopting a contrary view, has, instead of remanding, proceeded on this record to find the facts.

Fortunately, despite the absence of rebuttal evidence, there is sufficient in the record, principally from respondent's evidence, to indicate that the majority produced *de novo* findings contrary to the evidence.

In fact, a member of the consolidated group did make substantial tax savings payments to plaintiff. During the years from 1918 to 1924, one of the then affiliates, Utah Fuel Company, joined with plaintiff and respondent in the filing of consolidated returns. Plaintiff's losses offset against that affiliate's income in consolidated returns, gave rise to tax savings for that affiliate. Nonetheless, it did not keep those tax savings. Instead, it made tax savings payments to plaintiff, the parent.† Thus, the majority's finding (made without any discussion of these facts) that "the record is clear" that no tax payments were made (R. 2233), is refuted.

Nor was there in fact any practice worthy of the dignity and effect given to it by the Court below. Prior to bank-

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* The trial court itself had said (R. 1377):

"I just don't see the point of what any affiliated company has done in the past as a matter of practice in these returns, because they have all been decisions that have been made by the parent company, and when the parent company decided that it was proper to file affiliated returns, it filed them, * * *. What we have in this case is not concerned with that."

† The facts with respect to these payments appear from a Price Waterhouse report (Deft. Ex. 40, not printed pursuant to order; R. 2176).

ruptcy, tax savings fell into the pockets of both plaintiff and respondent (Deft. Ex. 46, 47; R. 2040-1); but to plaintiff, as the parent of an economic unit, it was immaterial, during the period, where they fell since in either event, as the tax laws intended, plaintiff automatically benefited therefrom. Thereafter, during bankruptcy, neither plaintiff nor respondent's trustees had taxable income until 1942 (Deft. Ex. 46, 47; R. 2040-1). And in 1942, unfettered by any so-called past practice, tax counsel was retained to advise, *inter alia,* on the "very critical question" of whether consolidated or separate returns should be filed (Pl. Ex. 39-B, 39-D; R. 544), and consolidated returns were then used merely because they were advantageous (R. 1759).

B

The findings of the Court below that the tax transactions were handled in conformance with "the policy and directions" of plaintiff.

The majority below states:

> "The conclusion is inescapable that Corporation's (plaintiff's) officers, when they filed consolidated returns, * * * were conforming with the policy and directions of Corporation" (R. 2229).

Necessarily, this must mean that plaintiff's "policy and directions" were formed and acted upon by its officers and counsel who were independent of respondent. The Court below found this independence: "The record is barren of evidence to support the contention that Corporation (plaintiff) was dominated by the subsidiary (respondent), * * *" (R. 2235).

These conclusions are belied by the District Court's own findings and the uncontradicted evidence in the record.

The findings of the District Court are unambiguous:

> "It was there (in the supplementary complaint) further alleged that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation, and that by reason of such con-

> trol plaintiff was caused to file the consolidated returns for the benefit of the defendant. Throughout the proceedings and in the trial, this has been referred to as 'duality of control'" (R. 264).
>
> "* * * there is a preponderance of the evidence in favor of the plaintiff's contention of 'duality of control'" (R. 272).

The trial court's opinion setting forth the chronology of events, constantly gives effect to these conclusions of fact. It reiterates that what was done in the handling of these tax transactions, was done not by plaintiff, but by respondent, *its* employees and *its* tax counsel (R. 261-263, 265). In short, it found that the men of divided allegiance did in fact serve the quick, not the dead.

The majority below nevertheless reached a contrary conclusion. But it did so simply by ignoring the facts. It portrayed the actors in these tax transactions as if they were independent representatives of plaintiff. Thus, the majority narrates the tax activities herein in terms of what was done by Mr. Curry, F. C. Nicodemus, Jr., and Mr. Polk and his law firm. Curry is described merely as plaintiff's president, and one time treasurer (R. 2224); F. C. Nicodemus, Jr., is described merely as "the General Counsel for Corporation" (plaintiff) (R. 2226); and Polk and his law firm are described as "independent tax experts" (R. 2226).

Briefly summarized, the uncontroverted facts, nowhere mentioned in the majority opinion, with respect to these persons are:

> Mr. Curry, as we have shown, supra (pp. 6-8), was, during the critical period, respondent's vice-president, an employee of respondent's trustees, receiving his compensation from them, not plaintiff and, finally, on retainer to the respondent for services in connection with the very tax transactions involved herein.
>
> F. C. Nicodemus, Jr., plaintiff's general counsel was, throughout the critical period, employed to rep-

resent respondent's trustees and respondent, and received his compensation from them while receiving no compensation from plaintiff (R. 533-6, 793, 1119-21, 1723, 1730-1, 1738, 2150, Def. Ex. 14, R. 1901).

Whitman, Ransom, Coulson & Goetz (Mr. Polk), for the tax services involved herein, were paid by respondent and not by plaintiff (R. 548, 557, 1721). Far from being "independent", this firm had the strongest ties to respondent. Throughout the reorganization it represented respondent's largest single creditor entitled under the plan to about 28% of respondent's stock, i.e., the James interests (R. 963); it was this representation and the "vital" stake of this client in respondent which caused that firm, shortly before their retention, to look into the manner in which respondent's tax matters were being handled and thereupon to be retained as tax counsel (R. 965, 536-548). As the representative of this large creditor interest, Mr. Coulson was made a member of respondent's reorganization committee and his firm became its counsel (Int. Ex. 15, R. 1625, Pl. Ex. 10; R. 1674, 1677). After reorganization, while his firm was still handling these tax transactions, he became a director of respondent, still representing the James 28% stock interest therein (R. 548).

The opinion is replete with other examples of the effect of this same sin of omission. For example: The majority says tax counsel was employed "upon the suggestion of General Counsel for Corporation" (plaintiff), citing plaintiff's exhibit 39B, R. 544 (R. 2226). In fact, this was Mr. Nicodemus' letter to his client, respondent's trustee, Mr. Schumacher. And in broaching this subject, Mr. Schumacher, writing to Nicodemus on trustee's stationery, clearly shows this:

> "As one of the Trustees of the Western Pacific Railroad Company, I am looking to you to cooperate with

> Mr. Matthew, General Counsel for the Trustees in protecting the trust estate in the preparation of the final return" (Pl. Ex. 39A; R. 544).

Again, the majority refers to another letter, Polk's letter of May 20, 1943 (Pl. Ex. 50) as a report addressed to Mr. Curry and circulated to Mr. Schumacher and Mr. Nicodemus (R. 2225). The trial court more accurately described this letter for what it was: a letter "addressed to Curry, vice-president of *defendant company*" (R. 265, ftn. 5); and it was circulated by Polk to his paying client, the trust[illegible] and the latter's New York attorney.

Thus, the majority's conclusion that what was done was in conformance with "the policies and directions" of plaintiff cannot stand comparison with the record and the findings of the trial court. The record establishes and the trial court's finding reflect that, in fact, respondent dominated and controlled plaintiff in the handling of the tax transactions.

The majority's error herein underlines the necessity for strictly adhering to the principle that trial courts, not appellate courts, ought to find the facts. The dissenting opinion below aptly summarized the vice of any other practice:

> "The cause should be reversed for failure to state adequate findings to support the judgment. Findings must be made in the Trial Court. Appellate courts have no such right or function. The majority opinion attempts to accomplish justification of the result below by drawing inferences, deductions and conclusions from evidence which they claim to find in the record. It would be possible for other judges to set up a diametrically opposite set of facts from which a judgment in favor of plaintiff might be based. The very reason that Rule 52 requires findings of fact is illustrated by the majority opinion. For the technical difficulties of finding a basis of fact for this judgment are many. Indeed, such difficulties are insurmountable" (R. 2241-2).

POINT III

The Court below's conclusions of law concerning the fiduciary relations and duties between the parties are not based on the application of any local law and are clearly contrary thereto.

The majority below held plaintiff to be respondent's fiduciary in the critical period, merely because of its ownership of respondent's worthless stock. It rejected plaintiff's contention that *respondent* was plaintiff's fiduciary in these tax transactions; interlocking management, says that Court, absent respondent's domination and control of plaintiff, does not give rise to a fiduciary relationship. It then assumed, arguendo, that respondent was under a fiduciary duty to deal "fairly" with plaintiff; it held that there was fairness so long as the *cestui,* plaintiff, suffered no damage.

The majority asserted all of the above conclusions without ascertaining what local law is applicable and without citing any local law whatsover so holding.

In each instance, the rule of law enunciated by the Court below is contrary to the local law applicable hereto.

A

The majority's conclusion of law that plaintiff was respondent's fiduciary is erroneous.

The majority holds plaintiff was respondent's fiduciary solely because it was "the sole owner of the subsidiary's capital stock". Clear beyond cavil is the contrary rule of law: Mere stock ownership does not make the parent a fiduciary of its subsidiary. *Allied Chemical and Dye Corporation* v. *Steel and Tube Co.,* 14 Del. Ch. 1, 120 Atl. 486; *Blaustein* v. *Pan American P. & T. Co.,* 263 App. Div. 97, 119, 31 N. Y. S. 2d 934, 956 (1st Dept., 1941), aff'd 293 N. Y. 281, 56 N. E. 2d 705 (1944); *Southern Pacific Co.*

v. *Bogert,* 250 U. S. 483 (1919); *Fletcher, Corporations,* Vol. 13 § 5811, pp. 127-8. All of the above authorities require, in addition to mere stock ownership, that the stockholder in fact dominate and control his corporation. This the Court below could not find. In fact, it conceded that during the critical period respondent "was no longer controlled by Corporation (plaintiff) but by the Trustees appointed by the bankruptcy court", and respondent's "railroad properties were controlled and operated by (said) trustees" (R. 2223, 2216).

The only authority cited by the majority below for its conclusion is *Consolidated Rock Products Co.* v. *DuBois,* 312 U. S. 510, 522 (1941). But there, too, at the very page cited, this Court plainly stated that it was imposing fiduciary duties on a holding company because "it has dominated and controlled its subsidiaries".* Strangely enough, the Court below, in another point in its opinion, states the same holding for that case: "Fiduciary duties also arise where one corporation dominates the other. *Consolidated Rock Products Co.* v. *DuBois,* 312 U. S. 510, 522."

B

The majority's holding that respondent was not plaintiff's fiduciary is erroneous.

Although the majority below conceded "there obviously existed an interlocking management," (R. 2223) it nonetheless held that, as a matter of law, "the mere fact of officers and directors in common does not create such a

* The Supreme Court's complete language reads (312 U. S., at 522):

"But equity will not permit a holding company, *which has dominated and controlled its subsidiaries,* to escape or reduce its liability to those subsidiaries by reliance upon self-serving contracts which it has imposed on them. A holding company, as well as others *in dominating and controlling positions* (*Pepper* v. *Litton,* 308 U. S. 295), has fiduciary duties to security holders of its system which will be strictly enforced." (Italics ours.)

fiduciary relationship" (R. 2222). The Court cites no authority whatsoever for this rule of law. The contrary, we submit, is a rule of universal application.

The law is the same in Delaware, where plaintiff is incorporated; in California, where defendant is incorporated; in New York, where the interlocking officers functioned and the returns were filed; and in other jurisdictions throughout the land. *Keenan* v. *Eshleman*, 23 Del. Ch. 234, 243-4, 2 Atl. 2d 904 (S. Ct., 1938); *Kennedy* v. *Emerald Coal & Coke Co.*, 42 Atl. 2d 398, 402 (S. Ct., Del., 1944); *Goodell* v. *Verdugo Canon Water Co.*, 138 Cal. 308, 71 Pac. 354 (1903); *Title Ins. & Tr. Co.* v. *California Development Co.*, 171 Cal. 173, 205-6, 152 Pac. 542 (1915); *Chelrob* v. *Barrett*, 293 N. Y. 442, 460-2, 57 N. E. 2d 825 (1944); *Globe Woolen Co.* v. *Utica G. & E. Co.*, 224 N. Y. 483, 489-90. 121 N. E. 378 (1918, Cardozo, J.); *Mayflower Hotel Stockholders Protective Committee* v. *Mayflower Hotel Corp.*, 173 F. 2d 416, 418-23 (App. D. C., 1949, with numerous references). *Geddes* v. *Anaconda Copper Mining Co.*, 245 Fed. 225 (C. C. A. 9, 1917), rev'd on other grounds, 254 U. S. 590 (1921).

The rule rests on wisdom, as old as Holy Writ, that "no man can faithfully serve two masters, whose interests are or may be in conflict"; *San Diego* v. *San Diego & L. A. R. Co.*, 44 Cal. 106, 113 (1872). Just as there is danger that a director, in dealing with his corporation, will favor his personal interests, so in transactions between interlocking corporations "the danger to be avoided is that a director or group of directors, common to two corporations, may, for reasons of self-interest, favor one of the entities in its dealings with the other"; *Mayflower Hotel* case, *supra*, 173 F. 2d, at 420. Hence, courts impose "the most careful scrutiny of transactions between the corporations represented by common directors, to the end that in the absence of arm's length bargaining, the scales may not, even through mistake or inadvertence, be unfairly tipped to one side or the other"; *Chelrob* v. *Barrett*, *supra*, 293 N. Y., at 461.

This Court has given the classical and most frequently cited formulation of this doctrine in *Geddes* v. *Anaconda Copper Mining Co.*, 254 U. S. 590, 599 (1921):

> "The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation; and where the fairness of such transactions is challenged, the burden is upon those who would maintain them to show their entire fairness; * * * This court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality and, we now add, in the soundest business policy."

The Court below rejected this universal rule without discussion of the above authorities. It merely held that, in addition to interlocking management there must be domination and control. It cited no authority whatsoever for this proposition. We know of none. (The Court further compounded this error by making its own finding of fact, contrary to the District Court's finding, that there was no domination and control (discussed *supra*, pp. 23-26).)

Certain other grounds are suggested in the majority's opinion as possible bases for its rejection of the rule of interlocking management: Absence of assertion or proof of "actual fraud" and the openness of dealing and the good faith of the parties are adverted to (R. 2219, 2226); however, the rule is applied nonetheless. Cases cited *supra*, p. 29; *Blum* v. *Fleishhacker*, 21 F. Supp. 527, 533 (D. C., N. D. Cal., 1937), mod. and aff'd 109 F. 2d 543, cert. den. 311 U. S. 665; *Goodell* v. *Verdugo Canon Water Co.*, 138 Cal. 308, 314, 71 Pac. 354 (1903). The issue, says the Court, is whether a *subsidiary* stood in a fiduciary relationship to a *parent* (R. 2222) and the interlocking management "was not of the subsidiary's making" but of the parent's (R. 2223). The rule of interlocking management is imposed with the same rigor whether the subsidiary or parent invokes its protec-

tion. *Potter* v. *Sanitary Co. of America*, 22 Del. Ch. 110, 194 Atl. 87 (1937); *Banco, Kentucky Co.'s Receiver* v. *National Bank of Kentucky's Receiver*, 281 Ky. 784, 137 S. W. 2d 357 (1939). Once duality is created—no matter by whom or how innocently—it subjects the entities to fiduciary standards in their dealings with each other. *In re James Estate*, 86 N. Y. Supp. 2d 78 (Surr. Ct., 1948).*

C

The Court below erred in holding that the fiduciary duty of fairness permits the fiduciary to use the *cestui* for its own profit so long as the *cestui* is not damaged thereby.

Having assumed, arguendo, respondent's fiduciary obligations to plaintiff, the Court below held that respondent could deal with plaintiff "for profit as long as there is no overreaching or unfairness" (R. 2221).

The Court then applied this standard. It concluded that respondent, by keeping all the profit, had nonetheless dealt fairly with its *cestui*, the plaintiff.

This was "fairness", said the Court, because it "did not sacrifice Corporation's (plaintiff's) interests to those of the subsidiary" (R. 2232). And there was no such "sacrifice" because plaintiff, poor and without income, could not use its own loss by itself to create tax savings for itself.

Shorthanded, the Court simply held that this fiduciary could profit at will from its dealings with its *cestui* so long as the *cestui* was not damaged thereby. This holding is not tendered as the applicable local law; it is supported by no authority. The law to the contrary is well established generally, as well as in cases specifically involving tax savings and the conduct of fiduciaries with respect thereto. (See

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* Moreover, as we have seen, this argument has a totally fallacious factual premise. Respondent and its trustees, not plaintiff, created the duality during the critical period. They made plaintiff's management and counsel their "full time employees" and made their tax counsel plaintiff's tax counsel. They alone compensated them for their services.

cases cited and discussed at length in plaintiff's accompanying petition.)

The majority's conclusion is particularly shocking as a rule of fiduciary conduct, which, formulated to require conduct far above the "morals of the market place", is here applied to require far less.

In its most basic terms, the filings of consolidated returns were indeed transactions designed to make a profit. Plaintiff and respondent each had an essential ingredient for achieving the profit. Plaintiff had a $75,000,000 loss; respondent had large taxable income. The tax savings could be made only if both got together on a joint course of action, namely, the plaintiff would file consolidated tax returns for both in which its loss would offset respondent's income with resulting tax savings of $17,000,000. This was done and the joint effort of both produced those savings or profits. But only one, of all people, the fiduciary, respondent, retained all the profit while plaintiff, its *cestui*, received none.

Can this result possibly be fairness by a fiduciary to its *cestui?*

Let us compare our case with a more usual commercial analogy: Suppose that a fiduciary manages two businesses, one belonging to himself, the other to his cestui. By combining the purchasing power of the two, he buys merchandise at prices cheaper than each business would have had to pay separately. However, the entire amount of the reduced price is kept by the fiduciary; the *cestui* gets none of the savings. Could it be doubted that the fiduciary would be held guilty of "overreaching or unfairness"? Would even the "morals of the market place" produce such a result were there strangers dealing at arm's length? Would it be any answer for the fiduciary to say that his *cestui* was undamaged because it was still getting the same old merchandise at the same old price?

We submit that in our case as in the above hypothetical case, any reasonable test of fairness would deny that a fiduciary can take all and give its *cestui* none of the results of their joint efforts.

Conclusion

This "serious and important litigation" has traveled a most unusual litigative road. The District Court, after a thirteen day trial and upon a voluminous record (R. 264), reached its conclusion on grounds not urged or briefed by any of the parties. Thereafter, the Court below, by a majority, affirmed. But it rejected the District Court's grounds. Instead, it substituted its own and, to do so, it in effect sought to constitute itself as the trial court. The majority opinion below is the result—shot through with improper and erroneous findings of fact, misconstruction of the federal tax laws, improper and erroneous application of the rules of fiduciary law, lack of regard for local law—all intertwined and inseparable grounds for the decision below. A dissenting opinion was written, and thereafter a further dissent, making the unusual suggestion that "this serious and important litigation" should be heard by all the Court of Appeals' Judges of the Ninth Circuit.

Thus, the cleavage among the four Judges (three District Court Judges and one Court of Appeals Judge), who have thus far heard this case, has been deep, vehement and fundamental. The four have voiced three significantly different and conflicting major points of view, with further conflicts on important legal and factual premises.

Undoubtedly, these conflicts and errors reflect the difficulty of the issues involved and the large amount at stake. Landmark cases, such as the instant one, beget such deep-seated differences. They likewise require and justify hearing by this Court to set those conflicts at rest authoritatively and finally.

For all of the reasons herein, we respectfully urge that substantial justice for the petitioners and for the thousands of stockholders of plaintiff, justifies the granting of this petition for certiorari.

Dated, June 25, 1952.

Respectfully submitted,

JULIUS LEVY,
Attorney for Petitioners.

APPENDIX

Text of Statutes and Regulations Relied On.

Internal Revenue Code

§ 23. *Deductions from gross income.* In computing net income there shall be allowed as deductions: * * *

(g) Capital losses.

(1) Limitation. Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

(2) Securities becoming worthless. If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

(3) Definition of securities. As used in paragraph (2) of subsection the term "securities" means (A) shares of stock in a corporation, and (B) rights to subscribe for or to receive such shares.

(4) Stock in affiliated corporation. For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. For the purposes of this paragraph a corportion shall be deemed to be affiliated with the taxpayer only if:

(A) at least 95 per centum of each class of its stock is owned directly by the taxpayer; and

(B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents (except rents derived from rental of properties to employees of the company in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price

of operating assets sold), annuities, or gains from sales or exchanges of stocks and securities; and

(C) the taxpayer is a domestic corporation.

* * * * * *

§ 141. Consolidated returns.

(a) Privilege to file consolidated income and excess-profits-tax returns. An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. The making of consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated income-tax return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for such part of the year as it is a member of the affiliated group. In the case of a corporation which is not a member of the affiliated group after March 31, 1942, of the last taxable year of such group which begins before April 1, 1942, such corporation shall not be considered a member of the affiliated group for consolidated income-tax-return purposes for such year but shall be considered a member of such group for consolidated excess-profits-tax-return purposes for such year, and the consent required in the case of such corporation shall relate only to the consolidated excess-profits-tax regulations.

(b) Regulations. The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making consolidated income- and excess-profits-tax returns and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income- and excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. Such regulations shall prescribe the amount of the net operating loss deduction of each member of the group which is attributable to a deduction allowed for a taxable year beginning in 1941 on account of property considered as destroyed or seized under section 127 (relating to war losses), and the allowance of the amount so prescribed as a deduction in computing the net income of the group shall not be limited by the amount of the net income of such member.

* * * * * *

(d) Definition of "affiliated group". As used in this section, an "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

* * * * * *

§ 52. * * * In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Treasury Regulation 104

§ 23.12:

(a) A consolidated return shall be made on Form 1120 by the common parent corporation for the affiliated group. Such return shall be filed at the time and in the office of the collector of the district prescribed for the filing of a separate return by such corporation.

(b) Each subsidiary must prepare duplicate originals of Form 1122, consenting to these regulations and authorizing the common parent corporation to make a consolidated return on its behalf for the taxable year and authorizing the common parent (or, in the event of its failure, the Commissioner or the collector) to make a consolidated return on its behalf (as long as it remains a member of the affiliated group), for each year thereafter for which, under section 23.11 (*a*), the making of a consolidated return is required. One of such forms as prepared by each subsidiary shall be attached to the consolidated return, as a part thereof; and the other shall be filed, at or before the time the consolidated return is filed, in the office of the collector for the district prescribed for the filing of a separate return by such subsidiary. No such consent can be with-

drawn or revoked at any time after the consolidated return is filed.

* * * * * *

§ 23.15:

(a) Except as provided in paragraph (*b*), the common parent corporation and each subsidiary, a member of the affiliated group during any part of a consolidated return period, shall be severally liable for the tax (including any deficiency in respect thereof) computed upon the consolidated net income of the group.

(b) If, at the time of filing a consolidated return, one or more, but not all, of the members of the affiliated group are in bankruptcy under the laws of the United States or in receivership in any court of the United States or of any State, Territory, or the District of Columbia, then the liability under paragraph (*a*) of each such member of the group with respect to the period covered by such return shall not exceed such portion of the consolidated tax liability for such period as the several corporations included in the consolidated return may, subject to the approval of the Commissioner, agree upon, or, in the absence of such an agreement, an amount equal to its liability for such year computed as if a separate return had been filed.

(c) If a subsidiary has ceased to be a member of the affiliated group, its liability under paragraph (*a*) shall remain unchanged, except that if such cessation occurred prior to the date upon which any deficiency is assessed and resulted from a bona fide sale of stock for fair value, the Commissioner may, if he believes that the assessment or collection of the balance of the deficiency will not be jeopardized, make assessment and collection of such deficiency from such former subsidiary in an amount not exceeding the portion thereof allocable to it upon the basis of income used in the computations respectively of the normal tax and any surtaxes included in such deficiency.

(d) Any agreement entered into by one or more members of the affiliated group with any other members of such

group or with any other person shall in no case have the effect of reducing the liability prescribed under this section.

§ 23.16.

(a) The common parent corporation shall be for all purposes, in respect of the tax for the taxable year for which a consolidated return is made or is required, the sole agent, duly authorized to act in its own name in all matters relating to such tax, for each corporation which during any part of such year was a member of the affiliated group. The corporations, other than the common parent, shall not have authority to act for or to represent themselves in any such matter. For example, all correspondence will be carried on directly with the common parent; notices of deficiencies will be mailed only to the common parent, and the mailing to the common parent shall be considered as a mailing to each such corporation; notice and demand for payment of taxes will be given only to the common parent, and such notice and demand shall be considered as a notice and demand to each such corporation; the common parent will file petitions and conduct proceedings before the Board of Tax Appeals, and any such petition shall be considered as having also been filed by each such corporation; the common parent will file claims for refund or credit; refunds will be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such corporation; and the common parent in its name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed by each such corporation. Notwithstanding the provisions of this paragraph, however, any notice of deficiency, in respect of the tax for a consolidated return period, will name each corporation which was a member of the affiliated group during any part of such period, and any assessment (whether of the original tax or of a deficiency) will be

made in the name of each such corporation (but a failure to include the name of any such corporation will not affect the validity of the notice of deficiency or the assessment as to the other corporations); any notice and demand for payment will name each corporation which was a member of the affiliated group during any part of such period (but a failure to include the name of any such corporation will not affect the validity of the notice and demand as to the other corporations); and any distraint (or warrant in respect thereof), any levy (or notice in respect thereof), any notice of a lien, or any other proceeding to collect the amount of any assessment, after the assessment has been made, will name the corporation from which such collection is to be made. The provisions of this paragraph shall apply whether or not a consolidated return is made for any subsequent year, and whether or not one or more subsidiaries have become or have ceased to be members of the group at any time. Notwithstanding the provisions of this paragraph, the Commissioner may, if he deems it advisable, deal directly with any member of the group in respect of its liability, in which event such member shall have full authority to act for itself.

Title 28 U. S. C., § 46(c)

Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court in banc shall consist of all active circuit judges of the circuit.

R. C. P., Rule 52(a)

In all actions tried upon the facts without a jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; * * *.

PAGE

Handy & Harman v. Burnet, 284 U. S. 136 (1931) 53
Higgins v. Smith, 308 U. S. 473 (1940) 73
Hurwitz v. Hurwitz, 136 F. 2d 796 (App. D. C., 1943) 85, 86

Jacuzzi Bros. v. Berkeley Pump Co., 191 F. 2d 632 (C. A. 9, 1951) 84
James Estate, In re, 86 N. Y. S. 2d 78 (Surr. Ct., 1948) 41

Kavanaugh v. Kavanaugh Knitting Co., 226 N. Y. 185, 123 N. E. 148 (1919) 41
Keenan v. Eshleman, 23 Del. Ch. 234, 2 Atl. 2d 904 (S. Ct., 1938) 36
Kelley v. Everglades Drainage District, 319 U. S. 415 (1943) 84
Kennedy v. Emerald Coal & Coke Co., 42 Atl. 2d 398 (S. Ct., Del., 1944) 36
King, Matter of, 183 N. Y. 440 (1906) 86
Kistler v. Gingles, 171 F. 2d 912 (C. A. 8, 1949) 84
Klaxon Co. v. Stentor El. Mfg. Corp., 313 U. S. 487 (1941) 37
Kupperman v. M. & J. Becker, Inc., 198 F. 2d 765 (C. A. 2, 1952) 84

Leslie v. Commercial National Bank in Shreveport, 28 F. Supp. 927 (D. C., W. D. La., 1939) 45, 46, 64

Mahler v. Oishei (N. Y. Co. Index No. 28485, N. Y. Sup. Ct., Nov. 12, 1947), reviewed 61 Harvard L. Rev. 1058 (1948) 46
Marian v. Mariani, 276 App. Div. 205, 93 N. Y. S. 2d 370 (1st Dept., 1949) 36, 38, 43, 44
Mayflower Hotel Stockholders Protective Committee v. Mayflower Hotel Corp., 173 F. 2d 416 (App. D. C., 1949) 36, 37
Mayo v. Lakeland Highlands Canning Co., 309 U. S. 310 (1940) 85
McClure v. O. Henry T. & A. Co., 184 F. 2d 636 (C. A. 7, 1950) 84
Meinhard v. Salmon, 249 N. Y. 458, 164 N. E. 545 (1928) 45
Mississippi Pub. Co. v. Murphree, 326 U. S. 438, 444 (1946) 86

PAGE

Natural Gas Pipeline Co. v. Slattery, 302 U. S. 300 (1937) 35

Oil Shares Inc. v. Commercial Trust Co., 304 U. S. 551 (1938) 84

Overfield v. Pennroad Corp., 42 F. Supp. 586 (D. C., E. D. Pa., 1941), rev'd on other grounds, 146 F. 2d 889 44

Park & Tilford v. Schulte, 160 F. 2d 984 (C. C. A. 2, 1947), cert. den. 332 U. S. 761 4

Pepper v. Litton, 308 U. S. 295 (1939) 36, 48

Potter v. Sanitary Co. of America, 22 Del. Ch. 110, 194 Atl. 87 (1937) 42

Reconstruction Finance Corp. v. Denver and R. G. W. R. Co., 328 U. S. 495 (1946) 11

Sausalito Bay Land Co. v. Sausalito Imp. Co., 166 Cal. 302, 136 Pac. 57 (1913) 36

San Diego v. San Diego & L. A. R. Co., 44 Cal. 106 (1872) 36

Southern Pacific Co. v. Bogert, 250 U. S. 483 (1919) 41, 66

Title Ins. & Tr. Co. v. California Development Co., 171 Cal. 173, 152 Pac. 542 (1915) 36, 41, 66

Trinity Buildings Corp. v. Commissioner, 40 B. T. A. 1315 (1939) 88

Truncale v. Universal Pictures Co., 76 F. Supp. 465 (D. C., S. D. N. Y., 1948) 46, 47

United States v. Chemical Foundation, 272 U. S. 1 (1926) 89

United States v. Cleveland, P. & E. R. Co., 42 F. 2d 413 (C. C. A. 6, 1930) 57

Western Pac. R. Co., In re, 124 F. 2d 136 (C. C. A. 9, 1941) 5

Young v. Higbee Co., 324 U. S. 204 (1945) 64

TABLE OF STATUTES AND REGULATIONS

PAGE

Bankruptcy Act, § 77 5
Federal Rules of Civil Procedure, Rule 52 .... 33, 39, 83, 85
Internal Revenue Act of 1918, § 240(a), 40 Stat. 1082 72
Internal Revenue Act of 1938, § 23(g), 52 Stat. 461 50
Internal Revenue Act of 1942, § 123, 56 Stat. 820 50

Internal Revenue Code, 26 U. S. C.:
- § 23(g)(4) .... 6, 50, 51, 91, App. 93
- § 122(b) .... 7, App. 94
- § 141 .... 6, 9, 51, 68, 73, App. 95

Judicial Code, 28 U. S. C.:
- § 46(c) 28, 31
- § 1254(1) 2
- § 1291 2
- § 1332 2

Securities and Exchange Commission, Rule U-45(b) (6), 17 C. F. R. (1949), § 250.45(b)(6) .... 45, 74, App. 103

Treasury Regulation 104, 26 C. F. R. (1949), § 23:
- § 23.12 .... 6, 55, App. 99
- § 23.15 .... 47, 56, 62, 73, App. 100
- § 23.16(a) .... 6, 25, App. 101

TABLE OF AUTHORITIES

PAGE

Federal Rules of Civil Procedure, Committee Note of 1946 to Rule 52(a) 86

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§ 1, Comment e, pp. 14-15 64

§ 197, Comment c, pp. 809-810 64

Senate Finance Committee, Report, 70th Cong., 1st Sess., S. R. 960 (1938) 52, 57